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STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**2/22/07**	Bill No:	**AB 968**
Tax:	**Property**	Author:	**Walters**
Related Bills:	**AB 293 (Strickland)** **AB 351 (Smyth)** **AB 388 (Gaines)** **AB 495 (Tran)** **AB 972 (Walters)**		

BILL SUMMARY

This bill would, among other things, increase the amount of the homeowners' property tax exemption from $7,000 of assessed value to 25% of the home's purchase price for first-time homebuyers.

ANALYSIS

CURRENT LAW

Article XIII, Section 3(k) of the California Constitution exempts from property taxation the first $7,000 of assessed value of an owner occupied principal place of residence. This exemption is called the "homeowners' exemption." Section 25 of Article XIII requires the state to reimburse local government for the resulting property tax revenue loss.

Existing law, pursuant to Section 3(k) of Article XIII, authorizes the Legislature to increase the amount of the homeowners' exemption if:

- local governments are reimbursed for the revenue loss; and,
- benefits to renters, currently provided via the renters' income tax credit, are increased by a comparable amount.

Section 218 of the Revenue and Taxation Code specifies eligibility for the exemption and sets the exemption at $7,000.

PROPOSED LAW

Homeowners' Exemption. This bill would amend Section 218 of the Revenue and Taxation Code to increase the amount of the homeowners' exemption to 25% of the purchase price of the dwelling for first-time homebuyers.

Renters' Credit. In addition, it would increase the income tax credit provided to renters as specified. The Franchise Tax Board administers the renters' credit and this analysis does not discuss that provision in detail. Additionally, the Board of Equalization's revenue estimate does not include its associated revenue impact.

BACKGROUND

Prior to the enactment of Proposition 13 in 1978, various property tax reform proposals were advocated in the 1960's and 1970's because at that time property taxes were based on a property's actual market value. Consequently, property was reassessed to its current market value on a cyclical basis and these periodic reassessments resulted in substantial property tax increases due to rapidly escalating real estate values, similar to the real estate market in recent years. To provide some measure of property tax relief to homeowners, the “homeowners’ exemption” was created in 1968 via a constitutional amendment. (Proposition 1-A; SCA 1 and SB 8, Stats. 1968). The exemption was equivalent to $3,000[1] of assessed value. In 1972, legislation was passed to increase the exemption to its current equivalent level of $7,000 beginning in 1974.[2] (SB 90, Stats.1972)

Numerous bills were introduced in the Legislature between 1972 and 1978 to increase the amount of the exemption. Apparently these bills were rejected, in part, because some viewed the use of a homeowners' exemption as a temporary means of providing property tax relief, the benefits of which would erode over time due to inflation. Some argued instead that a fundamental change to the property tax system was needed to contain rapidly increasing property taxes.

Ultimately, the property tax reform proposal adopted was Proposition 13 (Article XIIIA of the California Constitution). Approved by the voters in June 1978, it rolled back real property values to 1975 market value levels and limited future annual increases in assessed values to the rate of inflation, not to exceed 2%, as long as the property remained under the same ownership. Proposition 13 also limits the basic property tax rate to 1%. Previously, each taxing agency could determine and levy its own rate and the statewide average tax rate was about 2.67%.

Under Proposition 13, property is reassessed to its current market value only after a change in ownership. Generally, the sales price of a property is used to set the property’s assessed value and annual increases to that value are limited to the rate of inflation, not to exceed 2%. Thus, Proposition 13 established a new assessment value standard that requires property to be assessed based upon the market value of the property at the time it is acquired by the taxpayer, rather than the value it has in the current real estate market. For property owners, especially homeowners, the primary benefits of this system are that future property tax liability is determinable and annual increases are modest.

Related Bills. Since Proposition 13, numerous bills have proposed increasing the exemption using a variety of methods such as:

- increasing the exemption by a flat amount,
- varying the exemption according to the year of purchase,
- indexing the exemption for inflation, and
- increasing the exemption for certain classes of persons.

In 2002, the initiative process was used for the first time to attempt to increase the amount of the exemption and the renters’ credit via a direct vote of the people, but not enough signatures were obtained to place the measure on the ballot.

[1] The actual amount was $750 of assessed value; however, at that time, property was assessed at 25%, rather than 100%, of value.
[2] The actual amount was $1,750 of assessed value.

Previous measures to increase the homeowners' exemption are summarized in the following table.

Bill	Year	Author	Proposal
AB 1922	2005-06	Walters	25% exemption, no assessed value cap
AB 2738	2005-06	Wyland	Increase to $27,000 for over 62
AB 62	**2005-06**	**Strickland**	**Increase to 25% for 1st time homebuyers (gradually reduced to $7,000 over 10 years)**
AB 185	2005-06	Plescia	Increase to $10,000 for over 62
AB 2357	2003-04	Plescia	Increase to $10,000 for over 62
AB 211	2003-04	Maze	Increase to $17,000 for over 62, disabled or blind
AB 82	2003-04	Dutton	Increase to $32,000, plus index for inflation
Initiative	Signature drive ended 11/6/02 – Not Pursued	Howard-Jarvis Taxpayers Assoc. & Bill Simon	Increase to $32,000, plus index for inflation
AB 1844	2001-2002	Mountjoy	Increase to $17,000 for over 62, disabled, or blind
SB 48	2001-2002	McClintock	Index for inflation by California CPI
SB 48	2001-2002	McClintock	Increase to $25,000, plus index for inflation
AB 218	**2000-2001**	**Dutra**	**Increase for 1st time homebuyers with means test for income ($25,000 for 5 Years)**
AB 2288	**1999-2000**	**Dutra**	**Increase for 1st time homebuyers with means test for income ($43,000 for 5 years)**
AB 2158	1999-2000	Strickland	Increase to $8,750 for persons over 62
SCA 8	1999-2000	Johannessen	Increase to $20,000; delete renters' credit parity
AB 2060	1997-1998	Granlund	Increase to $20,000
ACA 43	1997-1998	Granlund	Increase to $20,000
ACA 5	1991-1992	Elder	Variable, according to assessed value
ACA 31	1991-1992	Frizzelle	Index for inflation by California CPI
ACA 47	1991-1992	Jones	25% exemption; no assessed value cap
ACA 3	1989-1990	Elder	Variable, depending on year acquired
ACA 9	1989-1990	D. Brown	25% exemption; $250,000 assessed value cap
ACA 31	1989-1990	Hannigan	15% exemption; $150,000 assessed value cap
ACA 55	1989-1990	Wright	Increase to $48,000
ACA 1	1987-1988	Elder	Increased to $25,000, plus index for inflation
ACA 25	1987-1988	D. Brown	25% exemption; $250,000 assessed value cap
AB 2141	1985-1986	Klehs	20% exemption; $50,000 exemption cap
AB 2496	1985-1986	Cortese	Increase in years with General Fund Reserves
AB 3086	1985-1986	Elder	Variable, depending on year acquired
AB 3982	**1985-1986**	**La Follette**	**Increase for 1st time home buyers**
ACA 49	1985-1986	Elder	Variable, depending on year acquired

COMMENTS

1. **Sponsor and Purpose.** The author is sponsoring this measure to provide property tax savings to first-time homeowners.

2. **The Constitution Specifies the Minimum Amount of the Exemption.** The $7,000 amount specified in the Constitution is the *minimum* amount of the exemption. The exemption may be statutorily increased, as long as there is an equivalent increase in the amount of the renters' credit and local governments are reimbursed for property tax revenue losses. This bill proposes to increase the renters' credit. Section 25 of Article XIII of the Constitution already requires the state to reimburse local government for any property tax revenue loss associated with the homeowners' exemption.

3. **Exemption Amount Unchanged Since the Enactment of Proposition 13.** The homeowners' exemption was enacted in 1968 and increased to its current level in 1974. Despite numerous attempts, the exemption has not been increased in more than 30 years. Arguments against increasing the exemption generally follow the line of reasoning that California property tax law, via Proposition 13, provides sufficient property tax relief and protections for homeowners. Opponents of increasing the exemption have also expressed concern over the fiscal impact of increasing the exemption, given limited resources and other competing needs, since the state would be required to fully reimburse local governments for the revenue loss as well as provide a comparable increase in benefits to renters via the renters' state income tax credit.

4. **The State Subvenes Property Tax Revenue Loss from the Homeowners' Exemption.** The homeowners' exemption is the only property tax exemption for which the state fully reimburses local governments. The state also makes subvention payments to offset property tax reductions for open space and agricultural property that receives preferential assessment treatment under the Williamson Act at the rate of $1 per acre for non-prime land and $5 per acre for prime land.

5. **It would be administratively more practical to set the exemption at 25% of current assessed value rather than 25% of purchase price.** The administrative issues of using purchase price include:
   - There would be no basis for calculating the amount of the exemption when the transfer is a non-sale transaction, since there is no purchase price.
   - When the purchase price is not the basis of it's assessed value because it was either too high or too low, then the exemption would not reflect 25% of the assessed value of the home.
   - How would the amount be determined when the first-time homeowner buys vacant land and then builds the residence?
   - How would the amount of the exemption be determined when the purchase price is for a mixed-use property, such as a farm with a house, or an owner-occupied multi-family property?

6. **No Maximum Cap to Amount of the Exemption.** The amount of the exemption would vary according to the price of a home. Similar bills in prior legislative sessions included an assessed value cap to establish an upper limit to the amount of the exemption provided to a homeowner.

7. **Related Legislation.** The following is a chart of the bills introduced to date to increase the homeowners' exemption.

Bill	Author	Renters' Credit	Inflation	Proposal
AB 293	Strickland	Legislative Intent	Yes	Increase to $22,000, plus index for inflation
AB 351	Smyth	$151 and $75	No	Increase to $27,000 for over 62
AB 388	Gaines	$430 and $215	No	Increase to $25,000
AB 495	Tran	$360 and $180	Yes	Increase to $25,000 for over 62, plus index for inflation
AB 968	**Walters**	**Index for Inflation**	**No**	**25% exemption for 1st time homebuyers**
AB 972	Walters	Index for Inflation	No	25% exemption

COST ESTIMATE

With respect to administration, the Board would incur insignificant costs in informing and advising local county assessors, the public, and staff of the law changes. These costs are estimated to be under $10,000.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

Existing property tax law provides for a homeowners' exemption in the amount of $7,000 of the full value of a "dwelling," as specified. The state is required to pay subventions to counties for the homeowners' exemptions to offset the resulting local property tax loss. The state reimbursement to the counties for 2005-06 totaled $433,864,000 on 5.5 million claims.

The total exempt value on these properties was $38,163,819,000. Therefore, the average tax rate for properties receiving the homeowners' exemption is:

$433,864,000 / $38,163,819,000, or 1.137%.

According to the California Association of Realtors (C.A.R.), a first-time home buyer is a person that has not owned a dwelling for at least the previous 3 to 5 years. This person would be eligible for first-time homebuyer assistance available through State and Federal housing programs. In 2006, the percentage of purchasers considered first-time homebuyers fell to 27.1%, the second lowest percentage all-time. Sales of existing, single-family detached homes in California totaled 477,360 in 2006, a decrease of 23.6% from the 2005 year-end total of 624,957. Detached single-family homes typically account for roughly 75% of all existing home sales annually. Thus, the number of all homes sold in 2006 was approximately 636,500 (477,360 / 75%). Also in 2006, new housing permits totaled almost 107,000.

Staff estimates that by January 1, 2008, the initial number of qualified purchasers for this exemption will be:

[(636,500 +107,000) x 27.1%], or about 201,500.

According to C.A.R. in 2006, the median price of a home purchased by a first-time homebuyer was $450,000, Therefore, under this bill, the average homeowners' exemption for qualified purchasers would be:

$450,000 x 25%, or $112,500.

It is estimated that the homeowners' exemption would initially increase by $105,500 from $7,000 to $112,500 for a full exemption. The initial average increase in the reimbursement is then computed as follows:

$105,500 x 1.137%, or about $1,200.

The estimated initial increase in the homeowners' exemption reimbursement is then:

201,500 claims x $1,200 = $241.8 million

The average annual rate of housing turnover for single-family detached homes in California is approximately 8 percent, based on information provided by C.A.R. Applying this turnover rate to the annual number of claims reduces the number of continuing claims for the higher exemption as follows:

Year		
1		201,500
2	201,500 x 92% =	185,380
3	185,380 x 92% =	170,550
4	170,550 x 92% =	156,906
5	156,906 x 92% =	144,354

As a result, the number of qualifying purchases over the first five years of this bill is then:

Year		
1	201,500 =	201,500
2	201,500 + 185,380 =	386,880
3	201,500 + 185,380 + 170,550 =	557,430
4	201,500 + 185,380 + 170,550 + 156,906 =	714,336
5	201,500 + 185,380 + 170,550 + 156,906 + 144,354 =	858,690

REVENUE SUMMARY

This bill would increase the state subvention reimbursement to local governments by $241.8 million in the first full year of operation, increasing each year based on the number of qualified purchases.

QUALIFYING REMARKS

From 1996 to 2005, the median price of single-family homes in California has appreciated an average of 11.6% annually, with a high of 21.3% from 2003 to 2004, and a low of -0.5% from 1995 to 1996. As a result, the number of first-time homebuyers as a percentage of total home sales greatly decreased over that same period. As evidenced by a dip in median home prices in the mid-1990s resulting in about half of all homes purchased in that period being purchased by first-time homebuyers, the relationship of median home prices to first-time homebuyers is reciprocal.

Going forward, it is reasonable to assume that as changes in the median home price affect the qualified homeowners' exemption value and the corresponding state subvention, changes in median home price may well have the opposite effect on the number of qualified first-time homeowners, as specified under this proposal.

Furthermore, the proposed increase in the homeowners' exemption amount may persuade qualified first-time homebuyers to remain in that home longer in order to retain the increased exemption amount since the exemption would drop to $7,000 with their next home. This could cause the turnover rate to decrease, and significantly affect the number of qualified first-time homeowners claiming this exemption, thereby also significantly increasing the state subvention reimbursement.

Additionally, it should be noted that this revenue estimate does not include the renters' tax credit provisions of this bill which are administered by the Franchise Tax Board

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